DEPARTMENT OF THE AIR FORCE
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Docket Nos. E-01345A-16-0036
E-01345A-16-0123

Attached please find the Federal Executive Agencies (FEA) Post-Hearing Brief for filing in the above-referenced proceeding.

Copies have been served to all parties on the attached Certificate of Service. Please place this document on file.

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Attach:
FEA's Post-Hearing Brief

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E-01345A-16-0123

I HEREBY CERTIFY that a true and correct copy of FEA's Post-Hearing Brief has been furnished by electronic mail (e-mail) and/or U.S. Mail this 10th day of May, 2017 to the following:

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Dated this 10th day of May, 2017.

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BEFORE THE

ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN	**DOCKET NO. E-01345A-16-0036**
IN THE MATTER OF FUEL AND PURCHASE POWER PROCUREMENT AUDITS FOR ARIZONA PUBLIC SERVICE COMPANY	**DOCKET NO. E-01345A-16-0123**

Post-Hearing Brief

of

Federal Executive Agencies

May 17, 2017

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Post-Hearing Brief of
Federal Executive Agencies

Federal Executive Agencies ("FEA"), by and through their undersigned counsel, file this Post-Hearing Brief.

I. Settlement Agreement

FEA supports the adoption and Arizona Corporation Commission "Commission" approval of the Proposed Settlement Agreement ("Agreement") filed on March 27, 2017 by the Staff of the Arizona Corporation Commission ("Staff') on behalf of nearly 30 intervening parties, including FEA.

FEA is a signatory to this Agreement because it is a reasonable compromise to many complex issues in this rate case. Approval of this Agreement will avoid unnecessary litigation expense, provide for a fair, just and reasonable resolution of a revenue increase needed to provide Arizona Public Service Company ("APS" or "Company") full recovery of its cost of service, while also mitigating the rate burden to customers.

The Agreement resolves the highly complex issues in the case concerning the Company's revenue requirement, the revenue spread across rate classes, and ultimately the design of rates. FEA agrees to the total settlement in aggregate, rather than individual elements of the settlement which comprise specific findings on revenue requirement, cost of service and rate design. The settlement represents a reasonable compromise on these complex issues, and the ultimate rates that will be imposed on retail customers are reasonable.

Importantly, specific elements of the settlement revenue requirement or cost of service are only reasonable in the context of the entire settlement. Based on the entire settlement, consisting of a revenue requirement, revenue spread and cost of service, FEA believes that the settlement is just and reasonable because it provides fair consideration to the Company to fully recover its cost of service while receiving fair compensation, while creating no more than a reasonable burden on customers to achieve this full cost recovery. For these reasons, FEA recommends the Commission adopt the Agreement, as filed on March 27, 2017. Any proposed amendments to the Agreement must be evaluated as a component of the settlement in total.

APS filed on June 1, 2016 for an electric base rate increase to take effect on July 1, 2017, and an additional 2% across-the-board increase to take effect in 2019. APS requested a gross base rate revenue increase of $433.4 million (15%), which includes $267.6 million of rider revenue that APS sought to roll into base rates. The net revenue increase originally proposed by APS was $165.9 million, or 5.74% of total revenue. This is the Company's first full base rate case since 2011.

The Agreement provides for a $94.624 million net revenue increase, or a $71.26 million (43%) reduction from the original net revenue increase request, effective on the date of the Commission's Decision in this case. The Agreement also allows for a follow-on base rate adjustment no later than January 1, 2019 to recover the Four Corners Selective Catalytic Reduction environmental retrofit expenditure. The Company's originally proposed spread of the revenue increase across customer classes is largely maintained in the Agreement, but with certain carve-outs for special purpose customers, meaning that the nearly 50% reduction off of the original $165.9 million revenue increase is shared equitably across all retail customer classes.

II. Cost of Capital

In its application, APS filed for a fair value rate of return of 5.84% which was based on a capital structure consisting of 55.8% common equity and 44.2% long-term debt. APS filed for a return on equity of 10.50%, an embedded cost of long-term debt of 5.13%, and a 1.0% return on the fair value increment.

In his direct testimony filed on December 21, 2016, FEA witness Michael P. Gorman took issue with APS's proposed capital structure, return on equity, and return on the fair value increment. In his review, Mr. Gorman observed the common equity ratio of his proxy group, as well as the adjusted debt ratio of the regulated utility industry, and determined that a capital structure consisting of 50.0% common equity and 50.0% long-term debt was reasonable and more in line with the comparable risk proxy group and utility industry.

Further, Mr. Gorman performed various analyses in an attempt to measure the investor required return on common equity. Based on the results of these analyses, Mr. Gorman determined that the cost of common equity fell within the range of 8.80% to 9.30%. Based on this range, Mr. Gorman recommended the Commission approve the approximate midpoint of 9.10% to be APS's return on equity.

Finally, Mr. Gorman took issue with APS's proposed 1.0% return on the fair value increment. Based on his review of current market conditions and various analyses, Mr. Gorman determined a 0.55% return on the fair value increment should be adopted if the Commission found it to be reasonable to include this fair value return component.

In the proposed settlement, the parties have agreed to a capital structure consisting of 44.2% / 55.8% long-term debt / common equity, a return on equity of 10.0%, and a return on the fair value increment of 0.8%. Collectively, this produces a fair value rate of return of

5.59%. FEA is not opposing the cost of capital, or any of its components, as filed in the proposed settlement.

III. Depreciation Rates and Expense

On December 21, 2016 Mr. Brian C. Andrews filed direct testimony on behalf of the FEA to address APS's proposed depreciation expense. In his direct testimony, Mr. Andrews concluded that APS overstated its depreciation rates for the Cholla Power Plant because it has shortened the life span of this plant. The resulting depreciation rates produced an excessive amount of depreciation expense and overstated the test year revenue requirement. He recommended that the existing depreciation rates related to the Cholla Power Plant should remain in effect until APS makes an official determination of the retirement plans for the Cholla Power Plant. Mr. Andrews' position would have resulted in a reduction to the test year depreciation expense of $23.9 million.[1]

The Agreement states that APS will lower its proposed annual depreciation expense by $20 million per year, resulting in a $61 million increase in the depreciation expense. This $20 million reduction is achieved by adjusting the proposed lives/net salvage rates for APS's distribution accounts and by accelerating the amortization of the present excess depreciation reserves for Palo Verde.

Although the Agreement does not address the concerns raised by the FEA on the topic of depreciation, the resulting adjustment is acceptable and provides similar relief to ratepayers. FEA agrees to the total settlement in aggregate, rather than individual elements of

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[1]Andrews Direct Testimony, page 2, lines 11-24.

the settlement which comprise specific findings on revenue requirement, cost of service and rate design.

IV. Spread of the Revenue Increase

APS Witness Mr. Miessner describes at pages 11-14 of his Direct Testimony that the Company used its cost of service study results as a guide when developing its proposed spread of the revenue increase to the various customer classes, but considered as well the concept of gradualism when determining its final proposed base rate increase for each retail class. Mr. Miessner explains:

> In general, rate classes which were most deficient in recovering their cost of service, or which had the lowest percent of cost to serve, received a relatively higher increase. Conversely, rate classes that were least deficient in cost recovery and had higher percent recoveries of cost to serve received a relatively lower allocated increase. . . . The requested increase [for the residential class] is above the proposed system-average increase, but will still leave residential customers below the cost of service. The goal is to gradually bring residential customers more in line with the cost of service over time.[2]

FEA witness Amanda Alderson proposed an alternative cost of service study that reflected three corrections to the New Mexico retail production allocator that APS had calculated, and recommended the study include a customer component in the development of certain distribution cost allocation factors. Ms. Alderson supported the Company's proposed jurisdictional and New Mexico retail production and transmission allocation methodologies, and finds them to be consistent with cost-causation principles. They also follow recently approved allocation methods for the Company and other investor owned utilities ("IOU") in Arizona, and neighboring states. Ms. Alderson also supports the revenue spread gradualism concepts used by the Company, as they are reasonable, and used frequently in other

[2] Miessner Direct Testimony, page 12, lines 10-13 and page 14, lines 3-5.

jurisdictions in the industry. However, Ms. Alderson proposed that the final revenue increase be based on her corrected proposed cost of service study results, and detailed her proposed spread of the increase to the New Mexico retail classes in Exhibit AMA-5.

The Company's originally proposed spread of the revenue increase across customer classes is largely maintained in the Agreement, but with certain carve-outs for special purpose customers, meaning that the nearly 50% reduction off of the original $165.9 million revenue increase is shared equitably across all retail customer classes. A comparison of the final settlement spread of the revenue increase, shown in Appendix L to the Settlement Agreement, to the Company's original proposed spread and FEA's proposed spread on Exhibit AMA-5, indicates that the settlement spread is generally in line with the Company's original proposal, but mitigated the proposed impact on certain rate classes that were calculated as providing above cost of service either by the Company's filed cost of service study or FEA's filed cost of service study. This settlement spread of the revenue increase represents a reasonable compromise on these complex issues, and the ultimate rates that will be imposed on retail customers are reasonable. FEA agrees to the total settlement in aggregate, rather than individual elements of the settlement which comprise specific findings on revenue requirement, cost of service and rate design. The Agreement resolves the highly complex issues in the case concerning the Company's revenue requirement, the revenue spread across rate classes, and ultimately the design of rates. For these reasons, FEA recommends the Commission adopt the Agreement.

By: ______________________________

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